



## **OXFORD ANALYTICA**

**CHILE**

**MONETARY TRANSPARENCY**

**Country Report 2005**

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# CHILE



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2005	2004	2003	2002
Clarity of roles	••••	••••	••••	••••
Open decision process	•••••	•••••	•••••	••••
Availability of information	•••••	•••••	••••	••••
Central bank accountability	••••	••••	••••	••••
<b>Score</b>	<b>4.50</b>	<b>4.50</b>	<b>4.25</b>	<b>4.00</b>

## OUTLOOK & COMMENTARY

Over the past years, Chile has adhered to a sound and consistent policy framework based on fiscal prudence and a successful monetary policy under an inflation-targeting framework. The Central Bank of Chile (BCC) remains committed to further improvements in the dissemination of timely information. A roadmap to implement the International Convergence of Capital Measurement and Capital Standards (known as Basel II) is publicly available, and targets for 2005 are likely to be met.

The government's debt with the BCC has been reduced in the past year owing partly to the attained fiscal surplus. The 2014 deadline to cancel the remaining debt appears more feasible than in previous years. Recapitalisation of the BCC needs a combination of efforts from BCC authorities, the central government and Congress, and the next administration (taking office in March 2006) may indeed gain the necessary momentum to address this shortcoming. A more detailed description of the functioning of audit procedures and internal norms for procurement are pending, and are likely to be publicly available in the near future.

## EXECUTIVE SUMMARY

### 4.50 Compliance in progress

Chile's high standard of compliance with the IMF Code on Good Transparency Practices for Monetary Policy is acknowledged both by international organisations and national observers. The objectives of the Central Bank of Chile (BCC) are clearly defined in its Organic Law, which requires the BCC to maintain stability of the Chilean currency and ensure the normal functioning of the system of internal and foreign payments. The elements of the inflation-targeting framework followed by the central bank are clearly explained on its website and related documents. Monetary policy is conducted through a reference overnight interest rate compatible with the inflation target.

The BCC's autonomy is protected by the constitution and strictly observed. The authorities have acknowledged the importance to recapitalise the BCC so as to further consolidate confidence in the independence of monetary policy and allow for a better understanding of fiscal policy, but little progress has occurred in the past year. The control and internal supervision of the BCC's accounts and operations is the responsibility of its General Auditor. Starting this year, the BCC has improved internal audit procedures, recruiting trained staff and appointing a Chief Auditor to whom the General Auditor has to report.

The Organic Law requires that financial institutions disclose information to the BCC, which is responsible for regulating the financial system and the capital market, and can dictate norms and conditions to financial institutions. Responsibility for inspecting financial institutions lies with the Superintendence of Banks and Financial Institutions (SBIF), which has recently improved the quality and timeliness of information publicly available. The BCC is committed to the implementation of an 'Integrated Risk Management System', establishing a new focus for managing risk (operational, financial, information technology, legal). The project started in late 2004 and has continued to progress during this year, with the creation of a risk value map, a treatment plan, and a monitoring and reporting system.

Chile is a subscriber to the IMF Special Data Dissemination Standard, and the BCC meets its standards for monetary reporting. The BCC maintains excellent public information services, and produces a variety of reports -- notably the quarterly *Monetary Policy Report*, the *Monthly Report* and the *Annual Report* -- on its activities and on the macroeconomic context. All BCC publications, together with timely information on international reserves, foreign debt, inflation and balance of payments are regularly posted and updated on the BCC's website. Starting this year, the BCC has changed the disclosure of monetary policy board meetings information, further improving its quality and timeliness. Minutes of the board meetings -- reflecting the different positions of its members and their votes -- are released, together with a *Background Information Report* containing detailed analysis, forecasts, and statistical information. Internal governance provisions are not publicly available, but efforts are currently being made to address shortcomings in order to strengthen operational transparency and market perceptions of integrity.

Chile's overall score is unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS

●●●● Compliance in progress

### The objectives and institutional framework of monetary policy

The Central Bank of Chile -- Banco Central de Chile (BCC)<sup>1</sup> -- is an autonomous institution governed by Chapter XII of the Constitution of Chile of 1980<sup>2</sup> and its Constitutional Organic Law.<sup>3</sup> The BCC's Organic Law establishes specific provisions for central bank duties, including performing in accordance with the general orientation of the government's economic policy.

#### Central bank objectives and responsibilities

The objectives of the BCC are clearly defined in Article 3 of the Organic Law, which requires the BCC to maintain stability of the Chilean currency and ensure the normal functioning of the system of internal and foreign payments. The objectives and responsibilities are clearly explained and commented upon in several publications, available on its website. It is responsible for regulating financial markets, international capital flows, and foreign exchange. In addition, it has other responsibilities such as the role of fiscal agent, lender of last resort, and the collection and publication of economic data.

The BCC has legal responsibility for international exchange transactions -- including the power of settling limitations and restrictions -- and its board determines foreign exchange policy. Chile operates a floating exchange rate system, although the central bank retains the right to intervene and to place restrictions on the operation of international exchange. While the charter gives the central bank clear responsibility for performing and regulating foreign exchange transactions, it does not explicitly refer to the institutional allocation of responsibility over the choice of the exchange rate regime.<sup>4</sup>

The IMF suggested in 2004 further steps in order to avoid conflicts between price and exchange rate stability within the inflation-targeting regime. According to the recommendations, there is an element of uncertainty in the interpretation of the statutory definition of the monetary policy objective, since currency stability may refer to internal (price) or external (exchange rate) stability. Even when BCC's greater policy flexibility could be perceived as an asset, it could also be viewed as a weakness to the extent that it does not explicitly support the inflation-targeting system.<sup>5</sup> Chilean authorities maintain that there is no need for clarifying the institutional and exclusive responsibility for foreign exchange rate policy, which is already specified in the current legislation. Past modifications to the exchange rate regime have always been conducted following pre-established regulations, with the participation of the Ministry of Finance, announced to the public through the *Official Gazette* and reported to the Senate.

#### Operational autonomy

The autonomy of the BCC is protected by the constitution, which gives it authority to use monetary and exchange rate instruments and thus effectively shields it from intervention by other branches of government. Article 2 of the Constitution stipulates that the BCC is governed exclusively by the regulations of its own charter, together with certain specific provisions of the General Banking Act. Several judicial pronouncements have ratified the BCC's independence from the government in the fulfilment of the public duty conferred on it by the central bank's charter.

Article 1 of the BCC's Organic Law establishes the central bank's financial, technical, and administrative autonomy, which is strictly observed in practice. At present, there are very few concerns that fiscal policy may undermine the effective autonomy of the BCC.<sup>6</sup>

Article 38 of the Organic Law authorises the BCC to keep, manage and use its international reserves, both within the country and abroad. It also has the authority to pledge such reserves as security of compliance with its obligations.

## **Institutional relationship between monetary and fiscal operations**

The BCC conducts monetary policymaking with operational independence from the government and fiscal institutions. It has to analyse the general orientation of the government's economic policies when passing a resolution through its board, and may obtain any necessary information from other public institutions when needed to achieve the appropriate implementation of monetary policy. The institutional relationship is thus one of coordination, subject to the primacy of central bank objectives.<sup>7</sup>

### **Lending to government**

Article 98 of the Constitution limits the ability of the BCC to provide direct and/or indirect lending to the government, except in cases of a state of emergency. In addition, Article 27 of the Organic Law establishes that the central bank can only grant financing or refinancing to banking entities and financial institutions, and prevents it from acquiring government debt -- whether issued by the central government or by any of the government agencies or state-owned enterprises. Using emergency powers -- introduced following the banking crisis of 1982-83 -- the BCC acquired government bonds from ailing financial institutions. The BCC and the Ministry of Finance have been arranging a change in the debt's denomination to reduce currency mismatches, and substantial pre-payments of these liabilities have been performed during 2005 owing to the large fiscal surplus attained and the government's commitment to meet the 2014 deadline to cancel out the debt. The debt currently amounts to approximately 3.7 billion US dollars, down from 6.9 billion in 2001. Since the 1980s crisis, the BCC has not carried out any new lending operations with the government or purchased government debt.

### **Central bank involvement in the rest of the economy**

The BCC's regulations for involvement in the rest of the economy are clearly defined in its Organic Law. Article 35 allocates authority to regulate financial markets and foreign exchange to the BCC. In addition to these activities, it may lend to private organisations and trade securities to ensure the stability of the financial and payments system. The procurement process is explained in the *Official Gazette*, where information on large contracts has to be published. Some shortcomings in the disclosure of internal norm codes regarding the acquisitions and the modalities for procurement are expected to be addressed in the near future, although no specific timetable has been prepared.<sup>8</sup>

### **Central bank profit allocation**

Section 5 of the BCC Organic Law specifies what the initial capital of the central bank is, and that it may be increased by decision of a majority of the board through capitalisation of reserves and adjusted by means of monetary correction. Therefore, a majority of board members can request the Ministry of Finance to increase the BCC's capital or make specific contributions to its assets on account of funds to be appropriated under the Budget Law.<sup>9</sup>

In addition, the Organic Law establishes that profits for each fiscal year should be distributed annually. Article 77 allocates up to 10% of the profits to central bank reserves. The remaining amount is transferred to the Treasury, unless a law allocates these resources in full or in part to the BCC's capital or reserves.

As mentioned above, after the banking crisis of 1982-83 the BCC purchased a substantial amount of public debt and other banking assets from ailing financial institutions, and these have led the central bank to incur losses of around 1% of GDP. This liability is a result of the differences between interest payments and interest revenue from government debt servicing, since almost half of the loss originates from the government debt with the BCC. In this context, Congress has authorised the BCC to change the denomination of the debt from dollars to Chilean pesos, which has helped align the structure of central bank credits and liabilities.

In order to improve monetary transparency, in its 2005 Article IV Consultation Report the IMF called on the government to introduce an appropriate and transparent mechanism to cover the annual deficits of the central bank, with a view to working toward its recapitalisation while preserving its institutional independence.<sup>10</sup> This capitalisation will in turn contribute to resolving the BCC's ongoing quasi-fiscal deficit. The authorities acknowledge the importance of recapitalising the BCC so as to further consolidate confidence in the independence of monetary policy and allow for a better understanding of fiscal policy. However, little progress has been achieved so far. The process will need a combination of efforts from BCC authorities, the central government and Congress, and some commentators judged this as unlikely to occur before the end of the current administration in March 2006.<sup>11</sup>

### **Agency roles performed by the central bank on behalf of the government**

The constitution and Article 37 of the BCC Organic Law clearly define the agency roles performed by the BCC on behalf of the government. These include an advisory relationship on monetary, financial, and foreign exchange matters with the President of the Republic. At the request of the Ministry of Finance, the central bank may act as a fiscal agent in the issuing of government domestic and foreign debt. It may also represent the government in dealings with foreign financial and international organisations, including participation in international lending negotiations. It is also empowered to issue securities and place them abroad, as well as to grant credit to foreign states, central banks or international financiers. It may also accept deposits from the government and state-owned enterprises, with a majority approval from members of the board. Interest earned by these deposits may not be above market rates.

In late 2003, Chile issued Law 19,913 in order to integrate and strengthen the legal and institutional framework to address anti-money laundering (AML) matters. The law is a substantial improvement on previous legislation: it updates the legal definition of the money laundering offence, imposes AML reporting obligations on a wider range of institutions, and provides the legal basis for creation of a Financial Analysis Unit with authority to issue regulations and monitor compliance.<sup>12</sup> However, banking secrecy provisions continue to limit the ability of the country to investigate potential money laundering offences and to provide effective international cooperation.<sup>13</sup>

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●●● Full compliance

### The framework, instruments and targets of monetary policy

Since 2000, the BCC has used a standard forecast inflation-targeting framework, within a flexible exchange rate regime. The country's framework has anchored inflation expectations and increased the economy's resilience to external shocks, maintaining price stability.<sup>14</sup> Liquidity is managed through open market operations to maintain a stable overnight reference interest rate. Details of this framework are made available on the central bank's website.<sup>15</sup> Any changes regarding monetary policy are widely published.

#### Framework and monetary targets

The main elements of the inflation-targeting framework in Chile currently consist of a pre-specified continuous inflation target band; a pre-announced "policy horizon"; and timely communication of the authorities' inflation forecast, the rationale for their policy decisions, and the reasons for any temporary deviations from the inflation target.

The BCC uses an annual inflation target that is centred on 3% while allowing a limited scope for volatility within limits of minus/plus 1%. The inflation target is measured through changes in the Consumer Price Index (CPI) produced by the National Statistics Institute (INE), although the monetary authorities focus their short-term analysis on a number of underlying CPIs. The INE produces an official figure for core inflation that limits seasonal price changes and short-term volatility.

The forecast horizon used for projecting inflation at the BCC is two years, with medium- to long-term deviations of inflation from the target triggering policy shifts. The BCC conducts monetary policy through a reference overnight interest rate compatible with the inflation target. Interventions are aimed at maintaining the stability of the reference rate.

Chile has had a flexible exchange rate since 1999, and free capital flows since April 2001. The exchange rate policy calls for zero intervention, but allows the possibility of conducting foreign exchange operations only under exceptional circumstances, such as in episodes of considerable volatility that the board of the BCC estimates to be outside market trends. Alongside the adoption of a floating exchange rate regime, the BCC committed itself in 1999 to a framework for the communication of the time span, size, and justification of its foreign exchange interventions. Since then, interventions have occurred two times, coinciding with regional financial turbulence.<sup>16</sup>

The IMF has recently observed that the floating exchange rate regime has benefited the economy and allowed it to adjust smoothly to external shocks. They commended the BCC's transparent policy framework, with seldom interventions in the foreign exchange market.<sup>17</sup>

#### Monetary instruments

The BCC conducts open market operations using an electronic auction system. Since August 2001, it has used a nominal interest rate (instead of a real interest rate) as the reference rate in its open market operations. This reflects the low inflation achieved, while discouraging the indexation of other contracts in the economy, especially to the

short end of the yield curve. The BCC also requires financial institutions to meet mandatory overnight deposits of 9% and medium-term deposits of 3.6%.

## **The monetary policy-making body**

Article 6 of the Organic Law of the BCC allocates authority to conduct monetary policy to the board of the BCC.

### **Monetary board**

Articles 6 to 21 of the BCC's Organic Law establish the composition, structure, and functions of the central bank's board. The board has five members appointed by the President of the Republic with the approval of a majority of the Senate. Members of the board are appointed for 10-year terms and are eligible for reappointment.<sup>18</sup> The president of the BCC is the president of its board and is appointed by the President of the Republic from among board members. The minister of finance is not a board member, but is authorised by the Organic Law to attend its meetings, with the right to speak but not to vote.<sup>19</sup> It can suspend the application of board resolutions not taken with unanimity, for a maximum of fifteen days, and may in that time ask the BCC president to call for an extraordinary board meeting to review the decision.

Board members are afforded explicit legislative assurances that strengthen independence from short-term political pressures and allow them to give greater weight to price stability. The President of the Republic, with justified reason and the prior approval of the Senate, may remove any or all of the board members. The dismissal may only be based upon the grounds that the concerned member has voted in favour of resolutions representing a material and clear breach of the purposes of the BCC as specified in its Organic Law, and provided that said resolution has been the main and direct cause of a material damage to the economy of the country.

An organisational chart, including board members, General Manager, General Counsel and Division Managers is published on the central bank website.

### **Advance meeting schedule**

The BCC's website includes a six-month advance meeting schedule for monetary policy board meetings. The board holds ordinary sessions once a month. The BCC lists dates of all board meetings since 1997, in addition to details of forthcoming meetings. It also provides minutes of the meetings, giving a concise outline of the rationale underpinning monetary policy decisions and the opinions of board members.. Decisions pursuant to the deliberations of the monetary policy board come into effect with the publication of the relevant resolution in the *Official Gazette*.

## **Public statements on monetary policy**

Central bank authorities publish a tri-annual *Monetary Policy Report (Informe de Política Monetaria)* that reviews recent domestic and foreign economic developments and the state of the foreign exchange and financial markets, as well as presenting medium-term growth and inflation forecasts. These reports also explain the policies pursued by the BCC to meet its inflation target based on a two-year period, explicitly describing inflationary risk scenarios. The September report coincides with the constitutionally mandated annual reporting to the Senate, which reviews and describes the policies and interventions undertaken by the BCC and includes a detailed analysis of the state of the national economy. The *Monetary Policy Report* usually includes a section on the explicit rationale for recent monetary policy decisions.



The BCC's *Annual Report* -- which has been published in English as well as Spanish since 1983 -- contains a full explanation of the main BCC operations, including monetary policy, financial policy, foreign exchange policy, related external audits, administrative measures, a description of past macroeconomic developments, and research and development activities. Information on the international outlook, balance of payments, international reserves, foreign debt, inflation, and wages is also included in this report. Models used by the BCC to prepare its forecasts are publicly available.

Starting in July this year, the BCC has changed the way in which it discloses information about board meetings to further improve the quality and timeliness. A press release is now available at the end of each meeting, underlying the principal decisions taken. In addition, after a three-week lag, minutes of the board meetings -- reflecting the different positions of BCC board members and their votes -- are released, together with the *Background Information Report*<sup>20</sup> that contains detailed analysis, forecasts, and statistical information.<sup>21</sup> The underlying principle is that decisions at the meeting should be taken on the basis of the same information that is available to the market.<sup>22</sup> Information on board meetings are publicly available on the BCC's website.<sup>23</sup> The website also makes available speeches and documents drafted by board members explaining policy decisions implemented during the year.

The *Macroeconomic Models and Central Bank Projections 2003* report presents a detailed analysis of the instruments and policies used by the BCC in determining its monetary policy and assessing potential developments.<sup>24</sup>

### **Periodic publications**

The *Monetary Policy Report* is published three times a year, in January, May, and September and, like the BCC's annual reports, it reviews monetary policy and inflationary risks.<sup>25</sup> The quality of this report has increased in the past year -- with more forecasting analysis and data -- and has been praised for its reliability by commentators.<sup>26</sup>

Since 2004, the *Monthly Report* has contained general economic information as well as a review of monetary aggregates, international reserves, and other macroeconomic data.<sup>27</sup> This new format is published on the 23rd of each month, and includes analysis of balance of payments, copper price, imports and exports, GDP, the BCC's Monetary Programme, international reserves, financial services, and external debt. During this year, a new section containing BCC financial circulars issued during the assessed period has been incorporated. Moreover, the *Monthly Report* now includes a detailed description of the statistical information provided. In addition, the *Monthly Progress Statistical Report* also includes economic statistics and has been welcomed by analysts. The *Daily News* contains monetary and foreign exchange information.

Since 2004, the BCC has published a *Financial Stability Report* twice a year that includes national and international macroeconomic and financial information; a progress report on foreign debt; the position of the non-banking financial institutions; and an overall assessment of the Chilean financial position. This publication is more analytical than statistical and has been envisaged to complement to the statistical information already available. In addition, the central bank has gradually expanded the availability of timely information -- both in Spanish and in English -- on its website. The BCC's Book Series on *Central Banking, Analysis, and Economic Policies* is available online. This series publishes new research on central banking and economics in general, with special emphasis on issues and fields that are relevant to economic policies in developing economies. Policy usefulness, high-quality research, and relevance to Chile are the main criteria for publishing books.

The BCC also carries out a survey of economic expectations among research institutions and independent experts. A number of publications covering developments on national statistics (such as *National Accounts, Balance of Payments and External Debt*) are also available online. In addition, the BCC issues weekly press releases with economic information, such as monetary aggregates and trade data.<sup>28</sup>

### **Public hearings**

Articles 66 to 74 of the Organic Law contain provisions for the publication of BCC's decisions and appeal procedures. The central bank has an online service for receiving comments on new norms and regulations that are under discussion. This includes the availability online of relevant documents and questionnaires. The system has been successfully used for issues like the implementation of a new payments system and real-time settlement of large transactions, and new regulations referring to liquidity.

### **Regulations on data reporting by financial institutions to the central bank**

Article 35 of the Organic Law requires that financial institutions disclose information to the BCC, which is responsible for regulating the financial system and the capital market and can dictate norms and conditions to banking and financial institutions. The regulatory framework and operating guidelines for the central bank's counterparts in the financial sector are publicly available on the website.<sup>29</sup>

Responsibility for inspecting financial institutions lies with the Superintendence of Banks and Financial Institutions (SBIF), whose activities and operational mandate are clearly established.<sup>30</sup> Detailed and up to date information on financial institutions is publicly available through the SBIF website, which has improved the quality and timeliness of its content during 2005. Ahead of the introduction of the International Convergence of Capital Measurement and Capital Standards (known as Basel II), Chile's banking industry and its regulatory authorities have been looking closely at the implications of the new recommendations. Commentators have suggested that Chile is well positioned to move into line with the new accord and will do so at the pace that best suits its own interests. A roadmap with detailed instructions to implement Basel II is publicly available, and targets scheduled for 2005 are likely to be met -- including submitting a proposal to align accounting standards.<sup>31</sup> Although the final decision for the implementation of Basel II will lead to amendment of the General Banking Law, SBIF's approach is to advance with a gradual de facto operation -- working in close collaboration with financial institutions -- before congressional approval. At present, SBIF objective is to ensure that financial institutions operate within a minimum homogeneous system.

The BCC has continued making progress in its programme to modernise financial regulations through changes to the methods used by financial institutions to manage liquidity risk. This project started in late 2004 and has continued progressing during this year with the creation of a risk value map, a treatment plan, and a monitoring and reporting system. A review of rules governing market risk concluded in January 2005 with the publication of new regulations for identifying, monitoring, and controlling it.<sup>32</sup> To ensure that banks could have a prudent period to adapt their market risk management systems to the new regulations, they only came into force from July 2005 onwards.

During the past year, efforts to consolidate the 'Real Time Gross Settlement System' -- established in early 2004 -- continued. This new scheme governs the transfer of funds in Chilean currency, individually and continually, with participating banks issuing instructions to transfer as soon as they have the necessary resources in their peso checking account at the BCC. The system -- which has reduced risks and increased timely information -- is administered by the BCC and every established banking firm in the country uses it. Before the end of the year, the BCC and the SBIF will coordinate an exercise among financial institutions to assess the functioning of the system.

Approval of the Capital Markets II draft law is likely to further enhance the financial system's efficiency and oversight. However, the approval of the bill -- submitted in 2003 -- remains unlikely before the end of the current administration in March 2006.<sup>33</sup>

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●●● Full compliance

#### Release of central bank data

Chile subscribes to the IMF Special Data Dissemination Standard (SDDS) and meets the standards for the release of a wide range of monetary information.<sup>34</sup> Article 53 of the BCC's Organic Law requires the central bank to compile and publish, in a timely fashion, principal national statistics, including monetary and exchange statistics, the balance of payments, and the national debt, as well as other general economic and social indicators. The data covers domestic and international lending, both to the private sector and publicly owned entities, and is praised for its high reliability. Liabilities are broken down into money, currency reserves, and promissory notes. The coverage, periodicity and timeliness of these statistics was established by Agreement N° 393-07-941207 of the BCC, published in December 13, 1994. Information on individual economic agents is considered confidential.

The *Daily News* and *Monthly Report* publications provide detailed information on BCC operations. These include regulations, open market operations, foreign exchange interventions, net and gross reserve levels, lender of last resort operations, monetary aggregates, and trade data. An advance release calendar that provides a quarter-ahead identification of precise release dates is published on the BCC's website.<sup>35</sup> The calendar is updated at least once a month and follows SDDS procedures. The BCC website contains a calendar of economic events that records not only monetary policy information but also general economic information such as CPI and employment statistics.<sup>36</sup> Starting this year, the BCC provides improved access to details of its open market operations.<sup>37</sup>

The BCC's *Monthly Indicator of Economic Activity* (IMACEC) is published with a lag of 35 days, down from 53 days. In addition, more information is published as regards different indicators of the behaviour of domestic prices.

#### The central bank balance sheet

The BCC publishes an annual balance sheet and an annual income statement. Prior to January 31 of each year, the General Manager has to submit to the board for its decision the financial statements for the last fiscal year. The annual BCC financial statement is submitted to the Ministry of Finance and the Senate prior to April 30 each year. Financial statements have to be submitted with an opinion issued by external auditors appointed by the board from among those auditors registered with the SBIF.<sup>38</sup> They are published, together with auditors' notes and opinions, in the *Official Gazette* and in a newspaper of national circulation. The BCC also releases monthly balance sheets with detailed information about outstanding liabilities and assets.

#### Lender of last resort

Article 36 of the Organic Law allows the central bank to carry out lender of last resort operations to financial institutions, with the exception of state-owned enterprises. Operations of this type may extend for up to ninety days. After that, loans can only be renewed with the agreement of the board's majority vote. These decisions are subject to a report from the SBIF. The BCC may lend to state-owned enterprises and the government only under a state of emergency clause. All lender of last resort operations are disclosed in press releases, the *Daily News*, and BCC income statements. Details of outstanding loans are available in the BCC balance sheets.

## Public information services

The central bank maintains good public information services and continues improving the quality and amount of information publicly available on its website, covering both statistical information and analysis of monetary policy. The Communications Department -- established in 2004 -- has continued enhancing the central bank's relationship with the press and market participants, ensuring the timely and fair distribution of information. Since the establishment of this department, the contact of BCC officials with the press has been reduced, and leakages of information have virtually disappeared.

In addition to the periodic publications mentioned above, the BCC releases a wide variety of documents and occasional publications -- like *Central Bank Economic Policy Documents*, *Central Bank Working Papers*, and the *Chilean Economy Magazine* -- that provide in-deep analysis of economic and financial policy, and which are publicly available online. The *Annual Report* and the *Monetary Policy Reports* are available in English. Regulations, circular letters, and resolutions are also readily available. Details of resolutions must be published within five days of their adoption.

The *Chilean External Debt Report* provides, on an annual basis, information on medium- and long-term foreign debt, broken down by public and private sector. It also provides data on short-term foreign debt. The information covers different classifications and refers to balances owed as of specific dates or annual movements (in-flows and out-flows of foreign credits) and projections for servicing the debt itself.

Information about the BCC's international reserves is publicly available through its website, even though supervision on how they are invested is limited. In addition, since March 2003, the BCC has started to release a report indicating how international reserves are managed.<sup>39</sup> In 2004, an explanation of how to read the data provided was incorporated, enhancing transparency procedures. Public availability of the principal macroeconomic series since 1986 has continued to improve. In addition, the BCC has a reliable newsletter system, providing information on current economic indicators and releases of publications and dissertations. The service is available through free subscription, both in Spanish and in English.

In 2003, the local Inverlink financial group admitted stealing financial documents worth over 100 million US dollars from a government agency. Moreover, Inverlink's stockbrokerage arm was revealed to have been buying market-sensitive information from the personal secretary of the former BCC president. The incident has not only damaged market confidence, but also undermined the government's credibility. Pressure on the BCC president to stand down because of his administrative responsibility for the information leaks from that organisation finally succeeded. As a result, the BCC has stepped up security, but has also reduced the time it holds market sensitive information before publishing it. Commentators have agreed about the positive role played by BCC officials in the timely reporting and investigating of the events. Procedures to manage sensitive information have been improved, including the reduction of time lags in the publication of relevant information for market participants, the use of more advanced technological procedures to protect privacy, and the modernisation of certain practices and regulations involving transactions and custody of securities in secondary markets.<sup>40</sup>

#### 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●●● Compliance in progress

##### **Accountability before a designated public authority**

The BCC prepares a report regarding its previous year's activities, which provides information on the execution of policies and programmes carried out in that period and includes the financial statements. The report is available to the public at the BCC's offices and is also submitted to the minister of finance and to the Senate prior to April 30 of each year. Some commentators have suggested that the Senate's technical capacity should be strengthened in order to increase its supervisory role.<sup>41</sup>

There is a legal requirement for the BCC board to submit, prior to 30 September of each year, to the minister of finance and the Senate an evaluation of the progress made by the implemented policies and programmes for the current year. This statement accompanies a report on the proposed policies and programmes for the next calendar year, stating the general economic projections on which such information is based and the possible effects they may have on major items in the financial statements for that period. Beyond the legal requirement, the BCC has been submitting reports on evaluation of progress of its policies on a quarterly basis. Although the BCC is only required to provide information on its policies, in practice it also provides extensive explanations justifying the appropriateness of its policy decisions.

##### **Financial statement**

The BCC's financial statements, detailing revenues and expenses of the BCC, are published annually as part of the *Annual Report*, and are accompanied by the opinion of external auditors.

##### **Audited financial statement**

The central bank's General Manager must produce the financial statement by 31 January of the next fiscal year. Subsequently, an auditing firm carries out the statement's external audit.

##### **External and internal audit**

The control and internal supervision of the BCC's accounts, operations and administrative regulations is the responsibility of its General Auditor. The General Auditor must report in writing to the president of the board, with a copy to the rest of its members, the comments and objections he may deem appropriate regarding accounts and operations.<sup>42</sup> These internally audited statements, having been reviewed by the General Manager, are then sent to external auditors designated by the BCC's board. In order to strengthen internal audit procedures, the BCC has recently recruited trained staff, and it has also appointed a Chief Auditor to whom the General Auditor now has to report. The Chief Auditor reports directly to the BCC's board. A more detailed description of the functioning of the internal audit unit is still pending, but likely to be made publicly available in the near future.<sup>43</sup>

A firm registered with the SBIF carries out the external audit of central bank accounts. Financial statements of the BCC are released according to the procedures approved by its board, which also need to be agreed by the SBIF. The financial statements contain a summary of significant accounting principles and notes from the auditors.

## Conduct of officials

The Organic Law of the BCC governs the code of conduct of employees, including its board. It comprises an extensive list of activities deemed incompatible with the role of board membership, and general staff conduct regulations. Board members are precluded from intervening or voting on resolutions in which they may have a commercial interest. The law also establishes that board members are under no obligation to appear in court, with the limitations provided in the codes of civil and criminal procedures.<sup>44</sup>

In 2002, Congress modified the Organic Law to prevent board members from having equity or ownership of financial institutions. As such, before taking office board members are required to declare their interests under oath. Following the Inverlink incident, in 2003 the central bank issued a document on *Ethical Standards and Secure Information* that BCC officials have to follow.<sup>45</sup>

Chilean authorities have indicated that some shortcomings regarding the public availability of procurement procedures, together with norms governing the ethical and personal conduct of staff, are in the process of being addressed. The BCC has committed to publish on its website a number of internal governance provisions in order to enhance operational transparency and market perceptions of integrity, although little progress was attained in the past year. In addition, the IMF has recommended the website publication of a note on internal rules regarding the personal financial affairs of the staff.<sup>46</sup>

Ongoing efforts to introduce new management techniques that enhance efficiency in the use of resources, minimise and manage financial and operating risk, and keep up with international standards for transparency and reputation are under way. Preferential development of human resources, transparency in budgetary management, and support for clear ethical rules, together with priority for identifying and controlling the risks inherent to BCC functions and responsibility, are among the most relevant guidelines provided by the central bank.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Chile between 26 and 28 September 2005:

### Central Bank of Chile

#### 28 September 2005

Rodrigo Valdes Pulido	General Manager	Department of Economic Research
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### Ministry of Finance

#### 27 September 2005

Mario Marcel Cullell	Director	National Budget Office
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## ADDITIONAL INTERVIEWS

#### 26 September 2005

Jorge Bustos	Partner	Ernst & Young Chile
Leonardo Suarez	Chief Economist	Larrain Vial Consulting
Diego Grunwald	Economist	Larrain Vial Consulting
Diego Figueroa Martinez	Economist	Larrain Vial Consulting

#### 27 September 2005

Salvador Seda	International Relations Director	Superintendence of Securities and Insurance
Christian Howard	Studies Division	Superintendence of Securities and Insurance
Gustavo Arriagada	Superintendent	Superintendence of Banks & Financial Institutions
Fernando Valdes Ossa	Correspondent	Superintendence of Banks & Financial Institutions
Juan Villarzú	Executive President	Copper National Corporation (CODELCO)

#### 28 September 2005

Axel Buchheister Rosas	Legislative Programme Director	Freedom and Development Institute
Felipe Morandé	Independent Consultant	



## NOTES

<sup>1</sup> The Central Bank of Chile (Banco Central de Chile) at: [www.bcentral.cl](http://www.bcentral.cl)

<sup>2</sup> Constitution of Chile of 1980, last amended in 2005 at: [www.bcn.cl](http://www.bcn.cl)

<sup>3</sup> Organic Law of the Central Bank of Chile at: [www.bcentral.cl/eng/funorg/organiclaw/](http://www.bcentral.cl/eng/funorg/organiclaw/)

<sup>4</sup> However, BCC has exerted clear responsibility for setting the exchange rate regime.

<sup>5</sup> 'Chile: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation', Country Report No.04/269, August 2004, available at: [www.imf.org](http://www.imf.org)

<sup>6</sup> Interviews in Chile, 26-28 September 2005.

<sup>7</sup> 'Chile: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation', Country Report No.04/269, August 2004, available at: [www.imf.org](http://www.imf.org)

<sup>8</sup> Interviews in Chile, 26-28 September 2005.

<sup>9</sup> 'Chile – Financial Sector Assessment Program. Detailed Assessment of Observance of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies', IMF Country Report No. 04/326, October 2004, available at: [www.imf.org](http://www.imf.org)

<sup>10</sup> 'IMF Executive Board Concludes 2005 Article IV Consultation with Chile', IMF Public Information Notice 05/104, August 2005, available at: [www.imf.org](http://www.imf.org)

<sup>11</sup> Interviews in Chile, 26-28 September 2005.

<sup>12</sup> According to Law 19,913, the Financial Analysis Unit is a decentralized public service agency attached to the Ministry of Finance whose mission is to prevent the financial system and other sectors of economic activity from being used to commit money-laundering offences.

<sup>13</sup> 'Chile – Report on the Observance of Standards and Codes – FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism', IMF Country Report No. 05/120, March 2005.

<sup>14</sup> Interviews in Chile, 26-28 September 2005.

<sup>15</sup> Monetary Policy of the Central Bank of Chile: Objectives and Transmission Mechanism at: [www.bcentral.cl/eng/stdpub/publications](http://www.bcentral.cl/eng/stdpub/publications)

<sup>16</sup> The latest BCC intervention occurred in 2002, as a consequence of regional instability. The central bank announced a temporary window of exchange market intervention, which was in practice less than the announced limits.

<sup>17</sup> 'IMF Executive Board Concludes 2005 Article IV Consultation with Chile', IMF Public Information Notice 05/104, August 2005, available at: [www.imf.org](http://www.imf.org)

<sup>18</sup> Article 8 of the BCC's Organic Law discusses the term of the members and establishes limits for their replacement, allowing for one member to be changed every two years.

<sup>19</sup> The minister also has the right to propose agenda items or specific policy decisions (such as monetary policy, foreign exchange, and financial regulation) for discussion.

<sup>20</sup> The *Background Information Report* first appeared in July 2005, and will be available every month except January, May and September, when the *Monetary Policy Report* is published.

<sup>21</sup> BCC policy in recent years has aimed to reduce time lags in disclosing monetary policy board meetings. During 2004, the minutes of board meetings were published a week before the next meeting, down from a 45-day lag -- which was previously shortened in 2003 from a ninety-day lag.

<sup>22</sup> Interviews in Chile, 26-28 September 2005.

<sup>23</sup> Information on BCC's board meetings, available at [www.bcentral.cl/esp/politicas/reunionespolitica/](http://www.bcentral.cl/esp/politicas/reunionespolitica/)

<sup>24</sup> *Macroeconomic Models and Central Bank Projections 2003 (Modelos Macroeconomicos y Proyecciones del Banco Central de Chile 2003)*, December 2003, available at: [www.bcentral.cl/esp/publ/indexper.htm](http://www.bcentral.cl/esp/publ/indexper.htm)

<sup>25</sup> *Annual Reports and Monetary Policy Reports*, publicly available at: [www.bcentral.cl/eng/stdpub/publications](http://www.bcentral.cl/eng/stdpub/publications)

<sup>26</sup> Interviews in Chile, 26-28 September 2005.

<sup>27</sup> A list of publicly available publications, including the *Monthly Report (Boletín Mensual)*, the *Financial Stability Report (Informe de Estabilidad Financiera)*, *Monthly Progress Statistical Report (Avance estadístico del Boletín Mensual)* and *Daily News (Informativo Diario)*, is available at: [www.bcentral.cl/esp/publ/indextema.htm](http://www.bcentral.cl/esp/publ/indextema.htm)

<sup>28</sup> Available at: [www.bcentral.cl/esp/infoeconomica/coyuntura/](http://www.bcentral.cl/esp/infoeconomica/coyuntura/)

<sup>29</sup> 'Chile: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation', Country Report No.04/269, August 2004, available at: [www.imf.org](http://www.imf.org)



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<sup>30</sup> See the Superintendence of Banks and Financial Institutions (*Superintendencia de Bancos e Instituciones Financieras*) website at: [www.sbif.cl](http://www.sbif.cl)

<sup>31</sup> 'Directrices de la Hoja de Ruta para la Transición hacia Basilea II', January 2005, available at: [www.sbif.cl/sbifweb/internet/archivos/publicacion\\_2723.pdf](http://www.sbif.cl/sbifweb/internet/archivos/publicacion_2723.pdf)

<sup>32</sup> This new approach is based on Basel Committee Recommendations of 1996, and recommendations from 2004 on managing interest rate risk -- an integral part of considerations included in Basel II.

<sup>33</sup> Interviews in Chile, 26-28 September 2005.

<sup>34</sup> IMF Special Data Dissemination Standards (SDDS) – Chile, at: <http://dsbb.imf.org/Applications/web/sddsnsdppage/>

<sup>35</sup> Available at: [www.bcentral.cl/esp/infoeconomica/fminedd/calendarioestadisticas/index.htm](http://www.bcentral.cl/esp/infoeconomica/fminedd/calendarioestadisticas/index.htm)

<sup>36</sup> Available at: [www.bcentral.cl/esp/infoeconomica/calendario/2005/01.htm](http://www.bcentral.cl/esp/infoeconomica/calendario/2005/01.htm)

<sup>37</sup> BCC Open Market Operations, available at: [www.bcentral.cl/esp/oma/](http://www.bcentral.cl/esp/oma/)

<sup>38</sup> Article 76, BCC's Organic Law.

<sup>39</sup> Available at: [www.bcentral.cl/esp/infoeconomica/fminedd/liquidez\\_intl/index.htm](http://www.bcentral.cl/esp/infoeconomica/fminedd/liquidez_intl/index.htm)

<sup>40</sup> Interviews in Chile, 26-28 September 2005.

<sup>41</sup> Interviews in Chile, 26-28 September 2005.

<sup>42</sup> Article 26, BCC's Organic Law.

<sup>43</sup> Interviews in Chile, 26-28 September 2005.

<sup>44</sup> Article 21, BCC's Organic Law.

<sup>45</sup> Available at: [www.bcentral.cl/esp/politicas/exposiciones/miembrosconsejo/pdf/2003/informe%20seguridad.pdf](http://www.bcentral.cl/esp/politicas/exposiciones/miembrosconsejo/pdf/2003/informe%20seguridad.pdf)

<sup>46</sup> Interviews in Chile, 26-28 September 2005. See also 'Chile – Financial Sector Assessment Program. Detailed Assessment of Observance of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies', IMF Country Report No. 04/326, October 2004.